No. 91-887

In the Supreme Court of the United States

OCTOBER TERM, 1991

SAMUEL KRUGLIAK AND RICHARD L. PHILLIPS, CO-DISPOSITION ASSETS TRUSTEES FOR THE MANSFIELD TIRE & RUBBER COMPANY, DEBTOR, PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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QUESTION PRESENTED

Whether an excise tax imposed under Section 4971 of the Internal Revenue Code, 26 U.S.C. 4971, is entitled to priority as an "excise tax" under Section 507(a)(7)(E) of the Bankruptcy Code, 11 U.S.C. 507(a)(7)(E).

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A1-A18) is reported at 942 F.2d 1055. The opinion of the district court (Pet. App. A19-A34) is reported at 120 Bankr. 862. The opinion of the bankruptcy court (Pet. App. A36-A54) is reported at 80 Bankr. 395.

JURISDICTION

The judgment of the court of appeals was entered on August 28, 1991. The petition for a writ of certiorari was filed on November 26, 1991. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. In 1977 and 1978, Mansfield Tire & Rubber Company maintained a qualified pension plan under Section 401 of the Internal Revenue Code, 26 U.S.C. 401. During this period, Mansfield failed adequately to fund its pension plan under the requirements of Section 412 of the Internal Revenue Code, 26 U.S.C. 412 (Pet. App. A20-A21). Mansfield therefore became subject to the provisions of Section 4971(a) of the Code, 26 U.S.C. 4971(a), which, during those years, imposed an excise tax of 5% on any accumulated funding deficiency of a qualified pension plan that existed at the end of the plan year.[1]

In October and November 1979, Mansfield and two related corporations filed petitions seeking relief under Chapter 11 of the Bankruptcy Code in the Bankruptcy Court for the Northern District of Ohio. In December 1979, pursuant to Section 4971(a) of the Internal Revenue Code, Mansfield filed excise tax returns for its 1977 and 1978 tax years, reporting excise tax liabilities of $101,380 and $213,828, respectively, for its failure to meet the minimum funding requirements of its pension plan (Pet. App. A2). Mansfield did not, however, make payment of this excise tax with its returns. The Internal Revenue Service therefore filed a proof of claim in the Mansfield bankruptcy case, asserting a priority claim

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[1] For single-employer plans, the statute now imposes a 10%, rather than 5%, excise tax on funding deficiencies. See 26 U.S.C. 4971(a). Section 4971(b) also provides for an additional tax of 100% of the amount of the funding deficiency when a deficiency existing at the end of a plan year is not corrected before the end of the taxable period. 26 U.S.C. 4971(b). The 100% tax is not involved in this case.

totaling $363,111 for the excise taxes reported on the returns (*ibid.*).

In December 1985, the bankruptcy court confirmed a consolidated plan of reorganization under which the assets of the three debtor corporations were transferred to a trust for liquidation and distribution of proceeds. Petitioners, as co-trustees of the liquidating trust, filed an objection to payment of the federal excise tax claims (Pet. App. A2).

2. The bankruptcy court sustained petitioners' objection (Pet. App. A48). Without discussing the provisions of Section 507(a)(7)(E) of the Bankruptcy Code that specifically provide a priority in bankruptcy distributions for prepetition "excise tax" liabilities of the debtor, the court focused instead (Pet. App. A39) on the provisions of the Bankruptcy Code that provide a priority to a "penalty" that compensates the government for pecuniary loss. 11 U.S.C. 507(a)(7)(G). Emphasizing the "long standing broad Congressional policy against punishing the innocent creditors of the bankrupt" (Pet. App. A41), the court concluded that the Section 4971(a) excise tax is a "penalty" adopted to enforce the statutory pension funding requirements, is not designed as "compensation for an actual pecuniary loss" (Pet. App. A48), and is therefore not entitled to priority under the Bankruptcy Code (*ibid.*).

Invoking Section 510(c)(1) of the Bankruptcy Code, 11 U.S.C. 510(c)(1), the bankruptcy court further held that the Section 4971 excise tax claim should be subordinated to the claims of general unsecured creditors (Pet. App. A53-A54). Section 510(c)(1) provides that the court may, after notice and hearing, subordinate an allowed claim "under principles of equitable subordination." The court held

that the excise tax claim should be subordinated pursuant to Section 510(c) because Congress "envisioned that penalty claims by their very nature, are to be subordinated" (Pet. App. A52, quoting *In re Colin*, 44 Bankr. 806, 810 (Bankr. S.D.N.Y. 1984)). The district court affirmed (Pet. App. A19-A34).

3. The court of appeals reversed (Pet. App. A1-A18). Recognizing that Section 507(a)(7)(E) expressly provides priority for "excise tax" claims, the court found the plain language of this statute to be dispositive: "Congress granted priority to excise tax claims without regard to whether their purpose was primarily regulatory" (Pet. App. A8). The court rejected petitioners' argument that a policy against penalizing innocent creditors required examination of the purpose of a federal excise tax in determining its priority (*id.* at A9).[2] Because the tax at issue in this case is unqualifiedly described by Congress as an "excise tax," the priority afforded to "excise taxes" under the Bankruptcy Code is plainly applicable (*id.* at A8 & n.3).

In reaching this conclusion, the court disagreed (Pet. App. A12) with decisions of other courts under the former provisions of the Bankruptcy Act (which

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[2] The court distinguished the question whether an "excise tax" label placed on a state or local exaction would be dispositive of the bankruptcy priority for "excise taxes" in Section 507(a)(7)(E) of the Code. In dicta, the court suggested that it would be "appropriate to more closely examine the particular [state or local] governmental claim to determine whether it truly is in the nature of a 'tax' as that term is used by Congress" (Pet. App. A10). Such examination is unnecessary when federal excise taxes are involved, for in these situations Congress has itself "exercised its constitutional power and deemed an exaction an 'excise tax'" (*ibid.*).

contained no express priority for "excise taxes," see 11 U.S.C. 104(a) (1976)) that had held that certain federal excise taxes were "penalties" rather than "taxes" and therefore not entitled to priority under the provisions of that superseded Act (see *In re Unified Control Systems, Inc.*, 586 F.2d 1036 (5th Cir. 1978); *In re Kline*, 403 F. Supp. 974 (D. Md. 1975), aff'd, 547 F.2d 823 (4th Cir. 1977)). The court of appeals stated that those cases "were wrongly decided to the extent that they held that the federal courts should look beyond the characterization of Congress to determine whether an exaction is a 'tax' entitled to priority under federal bankruptcy law" (Pet. App. A12).

Since Congress has now expressly declared that "excise taxes" are to be given priority under the Bankruptcy Code, the court rejected petitioners' alternative argument that the tax should be equitably subordinated to the claims of general unsecured creditors (Pet. App. A16-A18). The court found unacceptable the contention that "Congress set out a specific and comprehensive set of priorities for payment of claims in section 507 and then intended to give bankruptcy courts in section 510(c) the power to disregard those priorities whenever the bankruptcy court's view of general equity differed from the statutory scheme" (*id.* at A17).

ARGUMENT

The court of appeals correctly held that the excise tax imposed by Section 4971 of the Internal Revenue Code is entitled to priority under Section 507(a)(7)(E) of the Bankruptcy Code and may not be subordinated to the claims of general unsecured creditors. The decision in this case does not con-

flict with any decision of this Court or of any other court of appeals. Further review is therefore not warranted.

1. a. Congress enacted Section 4971 of the Internal Revenue Code as part of the Employee Retirement Income Security Act of 1974 (ERISA), Pub. L. No. 93-406, § 1013(b), 88 Stat. 920-921. In conneciton with the qualified pension plan arrangements authorized by ERISA, Section 4971 was enacted to "impose[] an excise tax on the employer if he fails to fund the plan at the minimum required amounts." H.R. Rep. No. 807, 93d Cong., 2d Sess. 97 (1974). Even before the Bankruptcy Code was enacted in 1978, Congress had thus expressly designated the tax imposed by Section 4971 as an "excise tax" (*ibid.*; see also H.R. Rep. No. 1280, 93d Cong., 2d Sess. (1974); S. Rep. No. 383, 93d Cong., 1st Sess. 24, 33, 70 (1973)).[3]

When the Bankruptcy Code was enacted, one of the many changes that it made to the provisions of the former Bankruptcy Act was the new, express specification of a priority for "excise tax" claims. Compare 11 U.S.C. 507(a)(7)(E) with 11 U.S.C. 104(a) (1976). The joint floor statements that accompanied enactment of the Bankruptcy Code in 1978

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[3] Contrary to petitioners' suggestion (Pet. 13-15), it is not necessary to rely on the classification scheme of the Internal Revenue Code to perceive that Congress expressly treated the tax imposed under Section 4971 as an "excise tax" (H.R. Rep. No. 807, *supra*, at 97). Section 4971 does not impose an excise tax because it appears in Subtitle D of the Internal Revenue Code (which is labelled "Miscellaneous Excise Taxes"); instead, it appears in Subtitle D because Congress understood and intended that Section 4971 *is* an "excise tax" (H.R. Rep. No. 807, *supra*, at 97).

described the intended scope of this specific "excise tax" priority: [4]

> All Federal, State, or local taxes *generally considered* or *expressly treated* as excise taxes are covered by this category, including sales taxes, estate and gift taxes, gasoline and special fuel taxes, and wagering and truck taxes.

124 Cong. Rec. 32416 (1978) (Rep. Edwards) (emphasis added); *id.* at 33998, 34016 (Sen. DeConcini) (same).

Since Congress had "expressly treated" the excise tax created under Section 4971 of the Internal Revenue Code as an "excise tax" even before the Bankruptcy Code was enacted, the court of appeals correctly concluded (Pet. App. A8) that this tax is entitled to priority under the plain language of Section 507(a)(7)(E).[5] As this Court held in *United*

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[4] There was no conference committee report on the Bankruptcy Code and these joint floor statements, which serve much the same purpose, have therefore been regarded as "persuasive evidence of congressional intent." *Begier* v. *IRS*, 110 S. Ct. 2258, 2266 n.5 (1990).

[5] Petitioner errs in suggesting (Pet. 16-17) that an "excise tax" that exacts a "penalty" is not an "excise tax" within the meaning of Section 507(a)(7)(E) of the Bankruptcy Code. An excise tax is no less an excise tax because it has a regulatory or punitive purpose. Indeed, excise taxes are ordinarily imposed on disfavored activities. Congress imposes excise taxes on alcohol and tobacco, rather than on bread and milk. See, *e.g.*, 26 U.S.C. 4064 (gas guzzler tax), 4681 (Supp. I 1989) (tax on ozone-depleting chemicals), 4701 (tax on "registration required" obligations issued in bearer form), 4911 (tax on excess lobbying by public charities), 4942 (tax on undistributed income, speculative investments, etc. of private foundations), 4955 (tax on political expenditures by Section 501(c)(3) organizations), 4971 *et seq.* (tax on certain activities and transactions with respect to qualified em-

States v. *Ron Pair Enterprises, Inc.*, 489 U.S. 235 (1989), where the language of the Bankruptcy Code is plain, " 'the sole function of the courts is to enforce it according to its terms.' " *Id.* at 241 (quoting *Caminetti* v. *United States*, 242 U.S. 470, 485 (1917)). While resort to the legislative history of these provisions is therefore unnecessary, as we have discussed above, that history leaves no room for any different conclusion in this case.

b. The decision of the court of appeals does not conflict with *United States* v. *Sotelo*, 436 U.S. 268 (1978), as petitioners contend (Pet. 6).[6] In *Sotelo*,

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ployer plans, IRAs, etc.), 4981 and 4982 (taxes on undistributed income of real estate investment trusts and regulated investment companies), 4999 (tax on "golden parachute" payments), 5881 (tax on "greenmail"). To the extent that payment of an excise tax is the price of disfavored conduct, the tax could be considered a penalty. In this way, virtually every federal excise tax could be viewed to some extent as a penalty. Yet Congress made clear that *any* tax that is "generally considered or expressly treated" as an "excise tax" has priority under Section 507(a)(7)(E). See 124 Cong. Rec. 32416, 34016 (1978).

[6] Petitioners also contend, without explanation or argument (Pet. 6), that the decision in this case conflicts with *City of New York* v. *Feiring*, 313 U.S. 283 (1941), and *New Jersey* v. *Anderson*, 203 U.S. 483 (1906). In those cases, this Court sought to determine whether a state exaction was a "tax" within the meaning of the priority afforded to "taxes" under the former provisions of Section 64 of the Bankruptcy Act. See 313 U.S. at 284 (personal property tax); 203 U.S. at 491 (franchise tax). The determination whether a state exaction was a "tax" within the meaning of that statute required resort to general principles concerning distinctions between general exactions imposed for public purposes and license or user fees imposed for private benefit. See *In re Lorber Industries of California, Inc.*, 675 F.2d 1062, 1066 (9th Cir. 1982) (state sewer use fee). These same princi-

the Court had before it the question whether the debtor's liability to pay withholding taxes under Section 6672 of the Internal Revenue Code was excepted from discharge under the former provisions of the Bankruptcy Act that provided that a discharge did not release the bankrupt from "any taxes * * * which the bankrupt has collected and withheld from others * * * but has not paid over" (11 U.S.C. 35(a) (1976)). Because the debtor had collected and not paid over withholding taxes in *Sotelo*, he was liable under Section 6672 of the Internal Revenue Code for "a penalty equal to the total amount of the tax" not paid over. 26 U.S.C. 6672(a). The Court held in *Sotelo* that the exception to discharge for any "tax" that the debtor "has collected * * * but has not paid over" applied whether the Internal Revenue Code described the government's *claim* against the debtor for those taxes as a "tax" or as a "penalty." As the Court stated, the funds that the debtor owed "were unquestionably 'taxes' at the time they were 'collected or withheld from others' " and they did not lose their "essential character as taxes" when the government later asserted its claim for them under Section 6672. 436 U.S. at 275.[7]

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ples were also sometimes employed to determine whether a "fee" imposed by Congress, while not labelled a "tax," was in the nature of a "tax" entitled to priority under the former provisions of that Act. See *United States* v. *River Coal Co.*, 748 F.2d 1103, 1106, (6th Cir. 1984). None of these decisions, however, supports petitioners' different contention that a federal "excise tax"—that Congress has expressly treated as an "excise tax" (H.R. Rep. No. 807, *supra*, at 97)—is not entitled to priority as an "excise tax" under the specific provisions of Section 507(a)(7)(E) of the Bankruptcy Code.

[7] The government collects the amount of the unpaid withholding taxes only once. *USLIFE Title Insurance Co.* v.

The decision in *Sotelo* thus turned on the specific language of former Section 17a of the Bankruptcy Act and the fact that the debtor had withheld and "not paid over" the taxes he had collected. 436 U.S. at 275.[8] Contrary to petitioners' assertions (Pet. 9-10), *Sotelo* does not stand for the broad proposition that, in determining priority of bankruptcy distribution, courts are to "look beyond Congress' denomination of an exaction, if the legislative label is unwarranted." To the contrary, the Court emphasized the narrow nature of its holding in *Sotelo* by limiting its decision to the specific situation presented in that case, where "liability is predicated on a failure to pay over, rather than a failure initially to collect, the taxes." 436 U.S. at 275.

Harbison, 784 F.2d 1238, 1243 (5th Cir. 1986). The potential liability of each "responsible person" under Section 6672 is reduced to the extent that delinquent taxes are paid by the corporation. See *United States* v. *Energy Resources Co.*, 495 U.S. 545 (1990).

[8] The present case is not, as petitioners maintain (Pet. 8), the "converse" of *Sotelo*. The priority provision at issue in this case contains an explicit and unqualified grant of priority for "excise taxes." In order to deny priority to the Section 4971 excise tax, it would be necessary to interpret the unqualified provisions of Section 507(a)(7)(E) as if they meant to grant a priority only to "excise taxes that do not have a deterrent or regulatory purpose." Congress plainly intended no such limitation. See pp. 6-7, *supra*. By comparison, in *Sotelo*, the discharge provisions at issue specified the nature of the obligation that would not be discharged (taxes that had been withheld but not paid over) and did not specify that the *claim* to enforce that obligation must itself be in the form of a "tax." 436 U.S. at 275. In contrast to petitioners' argument in this case, the Court in *Sotelo* did not disregard either the plain language or the clear intent of Congress in interpreting the statute before it.

c. Petitioners also err in contending (Pet. 18-20) that the decision in this case conflicts with the holdings of other courts—under the former provisions of the Bankruptcy Act—that certain federal excise taxes were not "taxes" within the meaning of the priority provisions of the former Act (*In re Unified Control Systems, Inc.*, 586 F.2d at 1037; *In re Kline*, 403 F. Supp. at 978). Those decisions, which were issued under the different provisions of the former Bankruptcy Act, have no bearing on whether taxes that Congress has "expressly treated" as "excise taxes" are entitled to priority as "excise taxes" under the new provisions of the Bankruptcy Code. See pp. 6-7 & n.6, *supra*. To the contrary, the text and history of the new Code make evident that the reasoning employed in these two pre-Code decisions is not applicable in determining the proper scope of the priority now provided to "excise taxes" under the new Code. Since the Bankruptcy Code was enacted in 1978, no court of appeals has held that an "excise tax" is *not* an "excise tax" within the meaning of the Code's new priority provisions.[9] There is thus no conflict among the courts of appeals on the question that was presented and decided in this case.

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[9] Two bankruptcy court decisions issued under the Bankruptcy Code erroneously relied on pre-Bankruptcy Code cases in holding that excise taxes are penalties that are not entitled to priority under the provisions of the new Code. See *In re Airlift International, Inc.*, 97 Bankr. 664 (Bankr. S.D. Fla. 1989), aff'd, 120 Bankr. 597 (S.D. Fla. 1990); *In re Wheeling-Pittsburgh Steel Corp.*, 103 Bankr. 672 (Bankr. W.D. Pa. 1989). These decisions did not address or consider either the express language or legislative history of Section 507(a)(7)(E) of the Bankruptcy Code, which establishes a priority for "excise tax" claims.

2. Petitioners acknowledge (Pet. 21) that an "excise tax" that is entitled to priority under Section 507(a)(7)(E) of the Bankruptcy Code may not be equitably subordinated to general unsecured claims under Section 510(c) of the Code. As the court of appeals correctly concluded (Pet. App. A17), since Congress established "a specific and comprehensive set of priorities for payment of claims in section 507," it cannot reasonably be contended that Congress "then intended to give bankruptcy courts in section 510(c) the power to disregard those priorities whenever the bankruptcy court's view of general equity differed from the statutory scheme" (Pet. App. A17). Petitioners therefore now concede that, if the excise tax established by Section 4971 of the Internal Revenue Code properly is entitled to priority under Section 507(a)(7)(E) of the Bankruptcy Code, they "would not assert that equitable subordination of those claims would still be warranted" (Pet. 21). Since petitioners do not disagree with this aspect of the decision below, further review is not warranted.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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